

107TH CONGRESS  
1ST SESSION

# H. R. 2520

To amend the Internal Revenue Code of 1986 to curb tax abuses by disallowing tax benefits claimed to arise from transactions without substantial economic substance, and for other purposes.

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## IN THE HOUSE OF REPRESENTATIVES

JULY 17, 2001

Mr. DOGGETT (for himself, Mr. RANGEL, Mr. STARK, Mr. MATSUI, Mr. COYNE, Mr. LEVIN, Mr. McDERMOTT, Mr. KLECZKA, Mr. LEWIS of Georgia, Mr. NEAL of Massachusetts, Mr. McNULTY, Mr. JEFFERSON, Mr. BECERRA, Mrs. THURMAN, Mr. ALLEN, Mr. BONIOR, Mr. HINCHEY, Mr. MCGOVERN, Mr. GEORGE MILLER of California, Ms. SANCHEZ, Ms. SCHAKOWSKY, Mr. TIERNEY, and Mrs. JONES of Ohio) introduced the following bill; which was referred to the Committee on Ways and Means

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## A BILL

To amend the Internal Revenue Code of 1986 to curb tax abuses by disallowing tax benefits claimed to arise from transactions without substantial economic substance, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Abusive Tax Shelter  
5 Shutdown Act of 2001”.

1 **SEC. 2. FINDINGS AND PURPOSE.**

2 (a) FINDINGS.—The Congress hereby finds that:

3 (1) Many corporate tax shelter transactions are  
4 complicated ways of accomplishing nothing aside  
5 from claimed tax benefits, and the legal opinions  
6 justifying those transactions take an inappropriately  
7 narrow and restrictive view of well-developed court  
8 doctrines under which—

9 (A) the taxation of a transaction is deter-  
10 mined in accordance with its substance and not  
11 merely its form,

12 (B) transactions which have no significant  
13 effect on the taxpayer's economic or beneficial  
14 interests except for tax benefits are treated as  
15 sham transactions and disregarded,

16 (C) transactions involving multiple steps  
17 are collapsed when those steps have no substan-  
18 tial economic meaning and are merely designed  
19 to create tax benefits,

20 (D) transactions with no business purpose  
21 are not given effect, and

22 (E) in the absence of a specific congres-  
23 sional authorization, it is presumed that Con-  
24 gress did not intend a transaction to result in  
25 a negative tax where the taxpayer's economic

1 position or rate of return is better after tax  
2 than before tax.

3 (2) Permitting aggressive and abusive tax shel-  
4 ters not only results in large revenue losses but also  
5 undermines voluntary compliance with the Internal  
6 Revenue Code of 1986.

7 (b) PURPOSE.—The purpose of this Act is to elimi-  
8 nate abusive tax shelters by denying tax attributes claimed  
9 to arise from transactions that do not meet a heightened  
10 economic substance requirement and by repealing the pro-  
11 vision that permits legal opinions to be used to avoid pen-  
12 alties on tax underpayments resulting from transactions  
13 without significant economic substance or business pur-  
14 pose.

15 **TITLE I—CLARIFICATION OF**  
16 **ECONOMIC SUBSTANCE DOC-**  
17 **TRINE**

18 **SEC. 101. CLARIFICATION OF ECONOMIC SUBSTANCE DOC-**  
19 **TRINE.**

20 (a) IN GENERAL.—Section 7701 of the Internal Rev-  
21 enue Code of 1986 is amended by redesignating subsection  
22 (m) as subsection (n) and by inserting after subsection  
23 (l) the following new subsection:

24 “(m) CLARIFICATION OF ECONOMIC SUBSTANCE  
25 DOCTRINE; ETC.—

1 “(1) GENERAL RULES.—

2 “(A) IN GENERAL.—In applying the eco-  
3 nomic substance doctrine, the determination of  
4 whether a transaction has economic substance  
5 shall be made as provided in this paragraph.

6 “(B) DEFINITION OF ECONOMIC SUB-  
7 STANCE.—For purposes of subparagraph (A)—

8 “(i) IN GENERAL.—A transaction has  
9 economic substance only if—

10 “(I) the transaction changes in a  
11 meaningful way (apart from Federal  
12 income tax effects) the taxpayer’s eco-  
13 nomic position, and

14 “(II) the taxpayer has a substan-  
15 tial nontax purpose for entering into  
16 such transaction and the transaction  
17 is a reasonable means of accom-  
18 plishing such purpose.

19 “(ii) SPECIAL RULE WHERE TAX-  
20 PAYER RELIES ON PROFIT POTENTIAL.—A  
21 transaction shall not be treated as having  
22 economic substance by reason of having a  
23 potential for profit unless—

24 “(I) the present value of the rea-  
25 sonably expected pre-tax profit from

1 the transaction is substantial in rela-  
2 tion to the present value of the ex-  
3 pected net tax benefits that would be  
4 allowed if the transaction were re-  
5 spected, and

6 “(II) the reasonably expected  
7 pre-tax profit from the transaction ex-  
8 ceeds a risk-free rate of return.

9 “(C) TREATMENT OF FEES AND FOREIGN  
10 TAXES.—Fees and other transaction expenses  
11 and foreign taxes shall be taken into account as  
12 expenses in determining pre-tax profit under  
13 subparagraph (B)(ii).

14 “(2) SPECIAL RULES FOR TRANSACTIONS WITH  
15 TAX-INDIFFERENT PARTIES.—

16 “(A) SPECIAL RULES FOR FINANCING  
17 TRANSACTIONS.—The form of a transaction  
18 which is in substance the borrowing of money  
19 or the acquisition of financial capital directly or  
20 indirectly from a tax-indifferent party shall not  
21 be respected if the present value of the deduc-  
22 tions to be claimed with respect to the trans-  
23 action are substantially in excess of the present  
24 value of the anticipated economic returns of the  
25 person lending the money or providing the fi-

1 nancial capital. A public offering shall be treat-  
2 ed as a borrowing, or an acquisition of financial  
3 capital, from a tax-indifferent party if it is rea-  
4 sonably expected that at least 50 percent of the  
5 offering will be placed with tax-indifferent par-  
6 ties.

7 “(B) ARTIFICIAL INCOME SHIFTING AND  
8 BASIS ADJUSTMENTS.—The form of a trans-  
9 action with a tax-indifferent party shall not be  
10 respected if—

11 “(i) it results in an allocation of in-  
12 come or gain to the tax-indifferent party in  
13 excess of such party’s economic income or  
14 gain, or

15 “(ii) it results in a basis adjustment  
16 or shifting of basis on account of over-  
17 stating the income or gain of the tax-indif-  
18 ferent party.

19 “(3) DEFINITIONS AND SPECIAL RULES.—For  
20 purposes of this subsection—

21 “(A) ECONOMIC SUBSTANCE DOCTRINE.—  
22 The term ‘economic substance doctrine’ means  
23 the common law doctrine under which tax bene-  
24 fits under subtitle A with respect to a trans-  
25 action are not allowable if the transaction does

1 not have economic substance or lacks a business  
2 purpose.

3 “(B) TAX-INDIFFERENT PARTY.—The  
4 term ‘tax-indifferent party’ means any person  
5 or entity not subject to tax imposed by subtitle  
6 A. A person shall be treated as a tax-indifferent  
7 party with respect to a transaction if the items  
8 taken into account with respect to the trans-  
9 action have no substantial impact on such per-  
10 son’s liability under subtitle A.

11 “(C) EXCEPTION FOR PERSONAL TRANS-  
12 ACTIONS OF INDIVIDUALS.—In the case of an  
13 individual, this subsection shall apply only to  
14 transactions entered into in connection with a  
15 trade or business or an activity engaged in for  
16 the production of income.

17 “(D) TREATMENT OF LESSORS.—In apply-  
18 ing subclause (I) of paragraph (1)(B)(ii) to the  
19 lessor of tangible property subject to a lease,  
20 the expected net tax benefits shall not include  
21 the benefits of depreciation, or any tax credit,  
22 with respect to the leased property and sub-  
23 clause (II) of paragraph (1)(B)(ii) shall be dis-  
24 regarded in determining whether any of such  
25 benefits are allowable.

1           “(4) OTHER COMMON LAW DOCTRINES NOT AF-  
 2           FECTED.—Except as specifically provided in this  
 3           subsection, the provisions of this subsection shall not  
 4           be construed as altering or supplanting any other  
 5           rule of law referred to in section 6662(i)(2), and the  
 6           requirements of this subsection shall be construed as  
 7           being in addition to any such other rule of law.”

8           (b) EFFECTIVE DATE.—The amendments made by  
 9           this section shall apply to transactions after the date of  
 10          the enactment of this Act.

## 11                           **TITLE II—PENALTIES**

### 12          **SEC. 201. INCREASE IN PENALTY ON UNDERPAYMENTS RE-** 13                           **SULTING FROM FAILURE TO SATISFY CER-** 14                           **TAIN COMMON LAW RULES.**

15          (a) IN GENERAL.—Section 6662 of the Internal Rev-  
 16          enue Code of 1986 (relating to imposition of accuracy-re-  
 17          lated penalty) is amended by adding at the end the fol-  
 18          lowing new subsection:

19               “(i) INCREASE IN PENALTY IN CASE OF FAILURE TO  
 20          SATISFY CERTAIN COMMON LAW RULES.—

21                       “(1) IN GENERAL.—To the extent that an un-  
 22          derpayment is attributable to a disallowance de-  
 23          scribed in paragraph (2)—

1           “(A) subsection (a) shall be applied with  
2           respect to such portion by substituting ‘40 per-  
3           cent’ for ‘20 percent’, and

4           “(B) subsection (d)(2)(B) and section  
5           6664(c) shall not apply.

6           “(2) DISALLOWANCES DESCRIBED.—A disallow-  
7           ance is described in this subsection if such disallow-  
8           ance is on account of—

9           “(A) a lack of economic substance (within  
10           the meaning of section 7701(m)(1)) for the  
11           transaction giving rise to the claimed benefit or  
12           the transaction was not respected under section  
13           7701(m)(2),

14           “(B) a lack of business purpose for such  
15           transaction or because the form of the trans-  
16           action does not reflect its substance, or

17           “(C) a failure to meet the requirements of  
18           any other similar rule of law.

19           “(3) INCREASE IN PENALTY NOT TO APPLY IF  
20           COMPLIANCE WITH DISCLOSURE REQUIREMENTS.—  
21           Paragraph (1)(A) shall not apply if the taxpayer dis-  
22           closes to the Secretary (as such time and in such  
23           manner as the Secretary shall prescribe) such infor-  
24           mation as the Secretary shall prescribe with respect  
25           to such transaction.”.

1 (b) MODIFICATIONS TO PENALTY ON SUBSTANTIAL  
2 UNDERSTATEMENT OF INCOME TAX.—

3 (1) MODIFICATION OF THRESHOLD.—Subpara-  
4 graph (A) of section 6662(d)(1) of such Code is  
5 amended to read as follows:

6 “(A) IN GENERAL.—For purposes of this  
7 section, there is a substantial understatement of  
8 income tax for any taxable year if the amount  
9 of the understatement for the taxable year ex-  
10 ceeds the lesser of—

11 “(i) \$500,000, or

12 “(ii) the greater of 10 percent of the  
13 tax required to be shown on the return for  
14 the taxable year or \$5,000.”

15 (2) MODIFICATION OF PENALTY ON TAX SHEL-  
16 TERS, ETC.—Clauses (i) and (ii) of section  
17 6662(d)(2)(C) of such Code are amended to read as  
18 follows:

19 “(i) IN GENERAL.—Subparagraph (B)  
20 shall not apply to any item attributable to  
21 a tax shelter.”

22 “(ii) DETERMINATION OF UNDER-  
23 STATEMENTS WITH RESPECT TO TAX  
24 SHELTERS, ETC.—In any case in which  
25 there are one or more items attributable to

1 a tax shelter, the amount of the under-  
2 statement under subparagraph (A) shall in  
3 no event be less than the amount of under-  
4 statement which would be determined for  
5 the taxable year if all items shown on the  
6 return which are not attributable to any  
7 tax shelter were treated as being correct. A  
8 similar rule shall apply in cases to which  
9 subsection (i) applies, whether or not the  
10 items are attributable to a tax shelter.”

11 (c) TREATMENT OF AMENDED RETURNS.—Sub-  
12 section (a) of section 6664 of such Code is amended by  
13 adding at the end the following new sentence: “For pur-  
14 poses of this subsection, an amended return shall be dis-  
15 regarded if such return is filed on or after the date the  
16 taxpayer is first contacted by the Secretary regarding the  
17 examination of the return.”

18 **SEC. 202. PENALTY ON PROMOTERS OF TAX AVOIDANCE**  
19 **STRATEGIES WHICH HAVE NO ECONOMIC**  
20 **SUBSTANCE, ETC.**

21 (a) PENALTY.—

22 (1) IN GENERAL.—Section 6700 of the Internal  
23 Revenue Code of 1986 (relating to promoting abu-  
24 sive tax shelters, etc.) is amended by redesignating

1 subsection (c) as subsection (d) and by inserting  
2 after subsection (b) the following new subsection:

3 “(c) PENALTY ON SUBSTANTIAL PROMOTERS FOR  
4 PROMOTING TAX AVOIDANCE STRATEGIES WHICH HAVE  
5 NO ECONOMIC SUBSTANCE, ETC.—

6 “(1) IMPOSITION OF PENALTY.—Any substan-  
7 tial promoter of a tax avoidance strategy shall pay  
8 a penalty in the amount determined under para-  
9 graph (2) with respect to such strategy if such strat-  
10 egy (or any similar strategy promoted by such pro-  
11 moter) fails to meet the requirements of any rule of  
12 law referred to in section 6662(i)(2).

13 “(2) AMOUNT OF PENALTY.—The penalty  
14 under paragraph (1) with respect to a promoter of  
15 a tax avoidance strategy is an amount equal to 100  
16 percent of the gross income derived (or to be de-  
17 rived) by such promoter from such strategy.

18 “(3) TAX AVOIDANCE STRATEGY.—For pur-  
19 poses of this subsection, the term ‘tax avoidance  
20 strategy’ means any entity, plan, arrangement, or  
21 transaction a significant purpose of the structure of  
22 which is the avoidance or evasion of Federal income  
23 tax.

24 “(4) SUBSTANTIAL PROMOTER.—For purposes  
25 of this subsection—

1           “(A) IN GENERAL.—The term ‘substantial  
2 promoter’ means, with respect to any tax avoid-  
3 ance strategy, any promoter if—

4           “(i) such promoter offers such strat-  
5 egy to more than 1 potential participant,  
6 and

7           “(ii) such promoter may receive fees  
8 in excess of \$500,000 in the aggregate  
9 with respect to such strategy.

10          “(B) AGGREGATION RULES.—For purposes  
11 of this paragraph—

12          “(i) RELATED PERSONS.—A promoter  
13 and all persons related to such promoter  
14 shall be treated as 1 person who is a pro-  
15 moter.

16          “(ii) SIMILAR STRATEGIES.—All simi-  
17 lar tax avoidance strategies of a promoter  
18 shall be treated as 1 tax avoidance strat-  
19 egy.

20          “(C) PROMOTER.—The term ‘promoter’  
21 means any person who participates in the pro-  
22 motion, offering, or sale of the tax avoidance  
23 strategy.

1           “(D) RELATED PERSON.—Persons are re-  
2           lated if they bear a relationship to each other  
3           which is described in section 267(b) or 707(b).

4           “(4) COORDINATION WITH SUBSECTION (a).—  
5           No penalty shall be imposed by this subsection on  
6           any promoter with respect to a tax avoidance strat-  
7           egy if a penalty is imposed under subsection (a) on  
8           such promoter with respect to such strategy.”

9           (2) CONFORMING AMENDMENT.—Subsection (d)  
10          of section 6700 of such Code is amended—

11                   (A) by striking “PENALTY” and inserting  
12                   “PENALTIES”, and

13                   (B) by striking “penalty” the first place it  
14                   appears in the text and inserting “penalties”.

15          (b) INCREASE IN PENALTY ON PROMOTING ABUSIVE  
16          TAX SHELTERS.—The first sentence of section 6700(a)  
17          of such Code is amended by striking “a penalty equal to”  
18          and all that follows and inserting “a penalty equal to the  
19          greater of \$1,000 or 100 percent of the gross income de-  
20          rived (or to be derived) by such person from such activ-  
21          ity.”

1 **SEC. 203. MODIFICATIONS OF PENALTIES FOR AIDING AND**  
2 **ABETTING UNDERSTATEMENT OF TAX LI-**  
3 **ABILITY INVOLVING TAX SHELTERS.**

4 (a) IMPOSITION OF PENALTY.—Section 6701(a) of  
5 the Internal Revenue Code of 1986 (relating to imposition  
6 of penalty) is amended to read as follows:

7 “(a) IMPOSITION OF PENALTIES.—

8 “(1) IN GENERAL.—Any person—

9 “(A) who aids or assists in, procures, or  
10 advises with respect to, the preparation or pres-  
11 entation of any portion of a return, affidavit,  
12 claim, or other document,

13 “(B) who knows (or has reason to believe)  
14 that such portion will be used in connection  
15 with any material matter arising under the in-  
16 ternal revenue laws, and

17 “(C) who knows that such portion (if so  
18 used) would result in an understatement of the  
19 liability for tax of another person,

20 shall pay a penalty with respect to each such docu-  
21 ment in the amount determined under subsection  
22 (b).

23 “(2) CERTAIN TAX SHELTERS.—If—

24 “(A) any person—

25 “(i) aids or assists in, procures, or ad-  
26 vises with respect to the creation, organiza-

1           tion, sale, implementation, management, or  
2           reporting of a tax shelter (as defined in  
3           section 6662(d)(2)(C)(iii)) or of any entity,  
4           plan, arrangement, or transaction that  
5           fails to meet the requirements of any rule  
6           of law referred to in section 6662(i)(2),  
7           and

8           “(ii) opines, advises, represents, or  
9           otherwise indicates (directly or indirectly)  
10          that the taxpayer’s tax treatment of items  
11          attributable to such tax shelter or such en-  
12          tity, plan, arrangement, or transaction and  
13          giving rise to an understatement of tax li-  
14          ability would more likely than not prevail  
15          or not give rise to a penalty,

16          “(B) such opinion, advice, representation,  
17          or indication is unreasonable,

18          then such person shall pay a penalty in the amount  
19          determined under subsection (b). If a standard high-  
20          er than the more likely than not standard was used  
21          in any such opinion, advice, representation, or indi-  
22          cation, then subparagraph (A)(ii) shall be applied as  
23          if such standard were substituted for the more likely  
24          than not standard.”

1 (b) AMOUNT OF PENALTY.—Section 6701(b) of such  
2 Code (relating to amount of penalty) is amended—

3 (1) by inserting “or (3)” after “paragraph (2)”  
4 in paragraph (1),

5 (2) by striking “subsection (a)” each place it  
6 appears and inserting “subsection (a)(1)”, and

7 (3) by redesignating paragraph (3) as para-  
8 graph (4) and by adding after paragraph (2) the fol-  
9 lowing:

10 “(3) TAX SHELTERS.—In the case of—

11 “(A) a penalty imposed by subsection  
12 (a)(1) which involves a return, affidavit, claim,  
13 or other document relating to a tax shelter or  
14 an entity, plan, arrangement, or transaction  
15 that fails to meet the requirements of any rule  
16 of law referred to in section 6662(i)(2), and

17 “(B) any penalty imposed by subsection  
18 (a)(2),

19 the amount of the penalty shall be equal to 100 per-  
20 cent of the gross proceeds derived (or to be derived)  
21 by the person in connection with the tax shelter or  
22 entity, plan, arrangement, or transaction.”

23 (c) REFERRAL AND PUBLICATION.—If a penalty is  
24 imposed under section 6701(a)(2) of such Code (as added

1 by subsection (a)) on any person, the Secretary of the  
2 Treasury shall—

3 (1) notify the Director of Practice of the Inter-  
4 nal Revenue Service and any appropriate State li-  
5 censing authority of the penalty and the cir-  
6 cumstances under which it was imposed, and

7 (2) publish the identity of the person and the  
8 fact the penalty was imposed on the person.

9 (d) CONFORMING AMENDMENTS.—

10 (1) Section 6701(d) of such Code is amended  
11 by striking “Subsection (a)” and inserting “Sub-  
12 section (a)(1)”.

13 (2) Section 6701(e) of such Code is amended by  
14 striking “subsection (a)(1)” and inserting “sub-  
15 section (a)(1)(A)”.

16 (3) Section 6701(f) of such Code is amended by  
17 inserting “, tax shelter, or entity, plan, arrangement,  
18 or transaction” after “document” each place it ap-  
19 pears.

20 **SEC. 204. FAILURE TO MAINTAIN LISTS.**

21 Section 6708(a) of the Internal Revenue Code of  
22 1986 (relating to failure to maintain lists of investors in  
23 potentially abusive tax shelters) is amended by adding at  
24 the end the following: “In the case of a tax shelter (as  
25 defined in section 6662(d)(2)(C)(iii)) or entity, plan, ar-

1 rangement, or transaction that fails to meet the require-  
2 ments of any rule of law referred to in section 6662(i)(2),  
3 the penalty shall be equal to 50 percent of the gross pro-  
4 ceeds derived (or to be derived) from each person with re-  
5 spect to which there was a failure and the limitation of  
6 the preceding sentence shall not apply.”

7 **SEC. 205. PENALTY FOR FAILING TO DISCLOSE REPORT-**  
8 **ABLE TRANSACTION.**

9 (a) IN GENERAL.—Part I of subchapter B of chapter  
10 68 of the Internal Revenue Code of 1986 (relating to as-  
11 sessable penalties) is amended by inserting after section  
12 6707 the following new section:

13 **“SEC. 6707A. PENALTY FOR FAILURE TO INCLUDE TAX**  
14 **SHELTER INFORMATION WITH RETURN.**

15 “(a) IMPOSITION OF PENALTY.—Any person who  
16 fails to include with its return of Federal income tax any  
17 information required to be included under section 6011  
18 with respect to a reportable transaction shall pay a penalty  
19 in the amount determined under subsection (b). No pen-  
20 alty shall be imposed on any such failure if it is shown  
21 that such failure is due to reasonable cause.

22 “(b) AMOUNT OF PENALTY.—

23 “(1) IN GENERAL.—The amount of the penalty  
24 under subsection (a) shall be equal to the greater  
25 of—

1           “(A) 5 percent of any increase in Federal  
2 tax which results from a difference between the  
3 taxpayer’s treatment (as shown on its return)  
4 of items attributable to the reportable trans-  
5 action to which the failure relates and the prop-  
6 er tax treatment of such items, or

7           “(B) \$100,000.

8 For purposes of subparagraph (A), the last sentence  
9 of section 6664(a) shall apply.

10           “(2) LISTED TRANSACTION.—If the failure  
11 under subsection (a) relates to a reportable trans-  
12 action which is the same as, or substantially similar  
13 to, a transaction specifically identified by the Sec-  
14 retary as a tax avoidance transaction for purposes of  
15 section 6011, paragraph (1)(A) shall be applied by  
16 substituting ‘10 percent’ for ‘5 percent’.

17           “(c) REPORTABLE TRANSACTION.—For purposes of  
18 this section, the term ‘reportable transaction’ means any  
19 transaction with respect to which information is required  
20 under section 6011 to be included with a taxpayer’s return  
21 of tax because, as determined under regulations prescribed  
22 under section 6011, such transaction has characteristics  
23 which may be indicative of a tax avoidance transaction.

1       “(d) COORDINATION WITH OTHER PENALTIES.—  
 2 The penalty imposed by this section is in addition to any  
 3 penalty imposed under section 6662.”

4       (b) CONFORMING AMENDMENT.—The table of sec-  
 5 tions for part I of subchapter B of chapter 68 of such  
 6 Code is amended by inserting after the item relating to  
 7 section 6707 the following:

“Sec. 6707A. Penalty for failure to include tax shelter information on return.”

8 **SEC. 206. REGISTRATION OF CERTAIN TAX SHELTERS**  
 9 **WITHOUT CORPORATE PARTICIPANTS.**

10       Section 6111(d)(1)(A) of the Internal Revenue Code  
 11 of 1986 (relating to certain confidential arrangements  
 12 treated as tax shelters) is amended by striking “for a di-  
 13 rect or indirect participant which is a corporation”.

14 **SEC. 207. EFFECTIVE DATES.**

15       (a) IN GENERAL.—Except as provided in subsections  
 16 (b) and (c), the amendments made by this title shall apply  
 17 to transactions after the date of the enactment of this Act.

18       (b) SECTION 201.—The amendments made by sub-  
 19 sections (b) and (c) of section 201 shall apply to taxable  
 20 years ending after the date of the enactment of this Act.

21       (c) SECTION 202.—The amendments made by sub-  
 22 section (a) of section 202 shall apply to any tax avoidance  
 23 strategy (as defined in section 6700(c) of the Internal  
 24 Revenue Code of 1986, as amended by this title) interests

1 in which are offered to potential participants after the  
2 date of the enactment of this Act.

3 (d) SECTION 206.—The amendment made by section  
4 206 shall apply to any tax shelter interest which is offered  
5 to potential participants after the date of the enactment  
6 of this Act.

7 **TITLE III—LIMITATIONS ON IM-**  
8 **PORTATION OR TRANSFER OF**  
9 **BUILT-IN LOSSES**

10 **SEC. 301. LIMITATION ON IMPORTATION OF BUILT-IN**  
11 **LOSSES.**

12 (a) IN GENERAL.—Section 362 of the Internal Rev-  
13 enue Code of 1986 (relating to basis to corporations) is  
14 amended by adding at the end the following new sub-  
15 section:

16 “(e) LIMITATION ON IMPORTATION OF BUILT-IN  
17 LOSSES.—

18 “(1) IN GENERAL.—If in any transaction de-  
19 scribed in subsection (a) or (b) there would (but for  
20 this subsection) be an importation of a net built-in  
21 loss, the basis of each property described in para-  
22 graph (2) which is acquired in such transaction shall  
23 (notwithstanding subsections (a) and (b)) be its fair  
24 market value immediately after such transaction.

1           “(2) PROPERTY DESCRIBED.—For purposes of  
2 paragraph (1), property is described in this para-  
3 graph if—

4           “(A) gain or loss with respect to such  
5 property is not subject to tax under this subtitle  
6 in the hands of the transferor immediately be-  
7 fore the transfer, and

8           “(B) gain or loss with respect to such  
9 property is subject to such tax in the hands of  
10 the transferee immediately after such transfer.

11 In any case in which the transferor is a partnership,  
12 the preceding sentence shall be applied by treating  
13 each partner in such partnership as holding such  
14 partner’s proportionate share of the property of such  
15 partnership.

16           “(3) IMPORTATION OF NET BUILT-IN LOSS.—  
17 For purposes of paragraph (1), there is an importa-  
18 tion of a net built-in loss in a transaction if the  
19 transferee’s aggregate adjusted bases of property de-  
20 scribed in paragraph (2) which is transferred in  
21 such transaction would (but for this subsection) ex-  
22 ceed the fair market value of such property imme-  
23 diately after such transaction.”

24           (b) COMPARABLE TREATMENT WHERE LIQUIDA-  
25 TION.—Paragraph (1) of section 334(b) of such Code (re-

1 lating to liquidation of subsidiary) is amended to read as  
2 follows:

3           “(1) IN GENERAL.—If property is received by a  
4 corporate distributee in a distribution in a complete  
5 liquidation to which section 332 applies (or in a  
6 transfer described in section 337(b)(1)), the basis of  
7 such property in the hands of such distributee shall  
8 be the same as it would be in the hands of the trans-  
9 feror; except that the basis of such property in the  
10 hands of such distributee shall be the fair market  
11 value of the property at the time of the  
12 distribution—

13           “(A) in any case in which gain or loss is  
14 recognized by the liquidating corporation with  
15 respect to such property, or

16           “(B) in any case in which the liquidating  
17 corporation is a foreign corporation, the cor-  
18 porate distributee is a domestic corporation,  
19 and the corporate distributee’s aggregate ad-  
20 justed bases of property described in section  
21 362(e)(2) which is distributed in such liquida-  
22 tion would (but for this subparagraph) exceed  
23 the fair market value of such property imme-  
24 diately after such liquidation.”

1           (c) EFFECTIVE DATE.—The amendments made by  
2 this section shall apply to transactions after the date of  
3 the enactment of this Act.

4 **SEC. 302. DISALLOWANCE OF PARTNERSHIP LOSS TRANS-**  
5 **FERS.**

6           (a) TREATMENT OF CONTRIBUTED PROPERTY WITH  
7 BUILT-IN LOSS.—Paragraph (1) of section 704(c) of the  
8 Internal Revenue Code of 1986 is amended by striking  
9 “and” at the end of subparagraph (A), by striking the  
10 period at the end of subparagraph (B) and inserting “,  
11 and”, and by adding at the end the following:

12                           “(C) if any property so contributed has a  
13                           built-in loss—

14   “(i) such built-in loss shall be taken  
15   into account only in determining the  
16   amount of items allocated to the contrib-  
17   uting partner, and

18   “(ii) except as provided in regulations,  
19   in determining the amount of items allo-  
20   cated to other partners, the basis of the  
21   contributed property in the hands of the  
22   partnership shall be treated as being equal  
23   to its fair market value immediately after  
24   the contribution.

1 For purposes of subparagraph (C), the term ‘built-  
2 in loss’ means the excess of the adjusted basis of the  
3 property over its fair market value immediately after  
4 the contribution.”

5 (b) ADJUSTMENT TO BASIS OF PARTNERSHIP PROP-  
6 erty ON TRANSFER OF PARTNERSHIP INTEREST IF  
7 THERE IS SUBSTANTIAL BUILT-IN LOSS.—

8 (1) ADJUSTMENT REQUIRED.—Subsection (a)  
9 of section 743 of such Code (relating to optional ad-  
10 justment to basis of partnership property) is amend-  
11 ed by inserting before the period “or unless the part-  
12 nership has a substantial built-in loss immediately  
13 after such transfer”.

14 (2) ADJUSTMENT.—Subsection (b) of section  
15 743 of such Code is amended by inserting “or with  
16 respect to which there is a substantial built-in loss  
17 immediately after such transfer” after “section 754  
18 is in effect”.

19 (3) SUBSTANTIAL BUILT-IN LOSS.—Section 743  
20 of such Code is amended by adding at the end the  
21 following new subsection:

22 “(d) SUBSTANTIAL BUILT-IN LOSS.—For purposes  
23 of this section, a partnership has a substantial built-in loss  
24 with respect to a transfer of an interest in a partnership  
25 if the transferee partner’s proportionate share of the ad-

1 justified basis of the partnership property exceeds 110 per-  
 2 cent of the basis of such partner's interest in the partner-  
 3 ship.”

4 (4) CLERICAL AMENDMENTS.—

5 (A) The section heading for section 743 of  
 6 such Code is amended to read as follows:

7 **“SEC. 743. ADJUSTMENT TO BASIS OF PARTNERSHIP PROP-**  
 8 **ERTY WHERE SECTION 754 ELECTION OR**  
 9 **SUBSTANTIAL BUILT-IN LOSS.”**

10 (B) The table of sections for subpart C of  
 11 part II of subchapter K of chapter 1 of such  
 12 Code is amended by striking the item relating  
 13 to section 743 and inserting the following new  
 14 item:

“Sec. 743. Adjustment to basis of partnership property where sec-  
 tion 754 election or substantial built-in loss.”

15 (c) **ADJUSTMENT TO BASIS OF UNDISTRIBUTED**  
 16 **PARTNERSHIP PROPERTY IF THERE IS SUBSTANTIAL**  
 17 **BASIS REDUCTION.—**

18 (1) **ADJUSTMENT REQUIRED.—**Subsection (a)  
 19 of section 734 of such Code (relating to optional ad-  
 20 justment to basis of undistributed partnership prop-  
 21 erty) is amended by inserting before the period “or  
 22 unless there is a substantial basis reduction”.

23 (2) **ADJUSTMENT.—**Subsection (b) of section  
 24 734 of such Code is amended by inserting “or unless

1       there is a substantial basis reduction” after “section  
2       754 is in effect”.

3           (3) SUBSTANTIAL BASIS REDUCTION.—Section  
4       734 of such Code is amended by adding at the end  
5       the following new subsection:

6       “(d) SUBSTANTIAL BASIS REDUCTION.—For pur-  
7       poses of this section, there is a substantial basis reduction  
8       with respect to a distribution if the sum of the amounts  
9       described in subparagraphs (A) and (B) of subsection  
10      (b)(2) exceeds 10 percent of the aggregate adjusted basis  
11      of partnership property immediately after the distribu-  
12      tion.”

13           (4) CLERICAL AMENDMENTS.—

14           (A) The section heading for section 734 of  
15       such Code is amended to read as follows:

16      **“SEC. 734. ADJUSTMENT TO BASIS OF UNDISTRIBUTED**  
17                           **PARTNERSHIP PROPERTY WHERE SECTION**  
18                           **754 ELECTION OR SUBSTANTIAL BASIS RE-**  
19                           **DUCTION.”**

20           (B) The table of sections for subpart B of  
21       part II of subchapter K of chapter 1 of such  
22       Code is amended by striking the item relating  
23       to section 734 and inserting the following new  
24       item:

      “Sec. 734. Adjustment to basis of undistributed partnership prop-  
          erty where section 754 election or substantial basis  
          reduction.”

1 (d) EFFECTIVE DATES.—

2 (1) SUBSECTION (a).—The amendment made  
3 by subsection (a) shall apply to contributions made  
4 after the date of the enactment of this Act.

5 (2) SUBSECTION (b).—The amendments made  
6 by subsection (a) shall apply to transfers after the  
7 date of the enactment of this Act.

8 (3) SUBSECTION (c).—The amendments made  
9 by subsection (a) shall apply to distributions after  
10 the date of the enactment of this Act.

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